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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Brighthouse Financial's First Quarter 2023 Earnings Conference Call. My name is Olivia, and I'll be your coordinator today. (Operator Instructions). As a reminder, this conference call is being recorded for replay purposes.

I would now like to turn the presentation over to Dana Amante, Head of Investor Relations. Ms. Amante, you may proceed.

Dana Amante - *Brighthouse Financial, Inc. - Head of IR*

Thank you, and good morning. Welcome to Brighthouse Financial's First Quarter 2023 Earnings Call. Materials for today's call were released last night and can be found on the Investor Relations section of our website. We encourage you to review all of these materials. Today, you will hear from Eric Steigerwalt, our President and Chief Executive Officer; and Ed Spehar, our Chief Financial Officer.

Following our prepared remarks, we will open the call up for a question-and-answer period. Also here with us today to participate in the discussions are Myles Lambert, our Chief Distribution and Marketing Officer; David Rosenbaum, Head of Products and Underwriting; and John Rosenthal, our Chief Investment Officer.

Before we begin, I'd like to note that our discussion during this call may include forward-looking statements within the meaning of the federal securities laws. Brighthouse Financial's actual results may differ materially from the results anticipated in the forward-looking statements as a result of the risks and uncertainties described from time to time in Brighthouse Financial's filings with the SEC.

Information discussed on today's call speaks only as of today, May 9, 2023. The company undertakes no obligation to update any information discussed on today's call.

During this call, we will be discussing certain financial measures that are not based on generally accepted accounting principles also known as non-GAAP measures. Reconciliation of these non-GAAP measures on a historical basis to the most directly comparable GAAP measures and related definitions may be found on our earnings release, slide presentation and financial supplement. And finally, references to statutory results, including certain statutory-based measures used by management are preliminary due to the timing of the filing of the statutory statements.

And now I'll turn the call over to our CEO, Eric Steigerwalt.

Eric Thomas Steigerwalt - *Brighthouse Financial, Inc. - President, CEO & Director*

Thank you, Dana. Good morning, everyone, and thank you for joining the call today. Brighthouse Financial entered 2023 in a position of strength and with a cautious view on the market and economic environment. We feel very good about our business franchise, our strong cash and capital position and our well-diversified and high-quality investment portfolio.

Profitable new business growth is essential to drive our business mix toward lower risk, higher return products and away from legacy variable annuities. We are very pleased with the progress that we continue to make towards shifting our business mix.

In the first quarter of 2023, we achieved strong annuity sales results. Total annuity sales were $2.8 billion, an increase of 35% compared with the first quarter of 2022. Sales of Shield Level and fixed deferred annuities were the largest contributors to the strong sales in the quarter at $2.5 billion combined. As I have said before, we are focused on providing a product portfolio that meets the evolving needs of our distributors and their clients. As part of that focus, we continue to seek ways to strengthen our flagship suite of annuity products.

Last week, on May 1, we announced new enhancements to our Shield Level Annuities product suite, including the launch of Shield Options with Step Rate Edge, a strategy that is designed to help clients keep their plans for retirement on track by providing additional growth opportunities in certain down markets.

Life insurance sales were $23 million in the first quarter of 2023, an increase of 15% compared with the first quarter of 2022 and the highest level of quarterly life insurance sales since the fourth quarter of 2021.

As we've said previously, we plan to introduce a new life insurance product later this year, which we expect will further diversify and strengthen our Life product suite. As we execute on our business strategy, we remain disciplined in our financial and risk management.

Maintaining balance sheet strength is imperative in order to support our distribution franchise and the growth and evolution of our business mix.

In the first quarter of 2023, Brighthouse delivered strong results with an estimated combined risk-based capital, or RBC ratio between 460% and 480%, which is above our targeted range of 400% to 450% in normal markets. And we continue to have a robust cash position with $1.1 billion of holding company liquid assets at the end of the first quarter.

We remain committed to returning capital to our shareholders. In the first quarter of 2023, we repurchased $62 million of our common stock with an additional approximately $27 million repurchased through May 5. As I said last quarter, while we have reduced the level of buybacks to reflect a cautious view on both the market and economic environment, we intend to maintain an active and opportunistic share repurchase program.

Since we began our common stock repurchase program in August of 2018, through May 5 of this year, we have reduced the number of shares outstanding by over 44%. Along with the lower level of common stock repurchases, we have taken additional actions over the past several years to further reduce our risk profile.

In the fourth quarter of 2021, we began derisking our investment portfolio by selling down portions of our emerging markets and high-yield portfolios. We repositioned approximately $2 billion from lower quality to higher-quality assets. This resulted in an approximately 20% reduction in the below investment-grade portion of our credit portfolio. As it relates to the office sector, we have intentionally reduced our office exposure within our commercial real estate loan portfolio from 40% in 2019 to 25% as of March 31, 2023. We have included slides in our earnings presentation, which provides some additional detail on our investment portfolio.

And as I have said previously, we added a substantial amount of low interest rate protection in 2022 to materially reduce tail risk associated with extremely low interest rates for an extended period of time.

We are very pleased with the proactive measures we took to further improve the quality of our balance sheet. These actions build upon other significant derisking efforts that we have implemented since becoming an independent public company and demonstrate our commitment to supporting growth of our franchise through a broad range of market scenarios.

To wrap up, despite the ongoing volatile market and economic environment, we continue to have a robust balance sheet. And our liquidity position remains very strong. Our investment portfolio is high quality and well diversified, and we believe that we are well positioned to weather challenging environments.

Additionally, we believe the combination of our focused business strategy, along with our disciplined approach to financial and risk management will drive increased shareholder return over time.

Now I'll turn the call over to Ed to discuss our financial results in more detail.

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Thank you, Eric, and good morning, everyone. Brighthouse Financial's first quarter 2023 results demonstrate the strength of our financial and risk management strategy as we navigate through an uncertain market and economic environment. As Eric mentioned, we continue to have a robust balance sheet as reflected in our preliminary statutory results for the first quarter of 2023. As of March 31, our estimated combined statutory total adjusted capital, or TAC, was approximately $8.2 billion, a $100 million increase compared with TAC as of December 31, 2022.

In the first quarter, TAC benefited from strong variable annuity, or VA results, and this performance was partially offset by elevated mortality. As of the end of the first quarter, our estimated combined risk-based capital or RBC ratio was between 460% and 480%. This compares with a combined RBC ratio of 441% at year-end 2022. In the first quarter, the RBC ratio benefited from normalized statutory earnings of approximately $200 million, which was driven by the previously mentioned favorable VA results. Additionally, the RBC ratio reflects lower capital requirements associated with new business.

Our liquidity position remains strong with holding company liquid assets of $1.1 billion as of March 31. As we have said previously, we believe it is appropriate to have a conservative cash position at the holding company. I would also like to remind you that the nondividend flows to the holding company cover most of our fixed charges, and we do not have any debt maturities until 2027.

Moving to adjusted earnings results. As of January 1, 2023, Brighthouse Financial adopted the new accounting standard for targeted improvements to the accounting for long-duration contracts or LDTI. With the adoption, historical data has been updated retrospectively.

First quarter adjusted earnings less notable items were $195 million, which compares with adjusted earnings on the same basis of $282 million in the fourth quarter of 2022 and $411 million in the first quarter of 2022. There were no notable items in the first quarter of 2023.

The adjusted earnings results in the quarter were impacted by lower than normal net investment income and a lower underwriting margin, partially offset by several favorable items, including lower expenses compared with our quarterly run rate expectation.

Net investment income was higher sequentially, driven by continued asset growth and higher alternative investment income. However, when compared to quarterly run rate expectations, the first quarter was approximately $80 million or $1.17 per share, lower than expected, driven by an alternative investment yield of 0 in the quarter. As a reminder, we expect an annual alternative investment yield between 9% and 11% over the long term.

The underwriting margin was lower sequentially and was lower than our quarterly run rate expectation. There is also an element of seasonality as direct claims are typically high in the first quarter relative to the full year quarterly average. As we have said before, we anticipate fluctuations in underwriting on a quarterly basis driven by variability in a number of factors, including frequency and severity of claims and the offset from reinsurance. The lower-than-expected underwriting margin was offset by seasonally low expenses along with better than run rate results in Corporate & Other.

Moving to sequential results by segment. Adjusted earnings, excluding notable items, in the Annuities segment were $314 million in the quarter. Sequentially, annuity results reflect higher fees driven by variable annuity separate account returns of 5.8%.

Additionally, under the new accounting standard, the attributed fees that are moved from adjusted earnings to market risk benefits or MRB, are seasonally lower in the first half of the year, contributing to the favorable sequential change in fees. Along with higher fees, expenses were lower sequentially, which was partially offset by lower net investment income.

The Life segment reported adjusted earnings excluding notable items of $1 million in the quarter. And the Run-off segment reported an adjusted loss, excluding notable items of $106 million. On a sequential basis, results in both Life and Run-off were driven by a lower underwriting margin, partially offset by higher net investment income and lower expenses.

Corporate & Other had an adjusted loss, excluding notable items of $14 million. On a sequential basis, results were driven by higher expenses, partially offset by higher net investment income.

To wrap up, our strong performance in the first quarter of 2023, demonstrates our ongoing focus on managing the company's balance sheet using a multiyear, multi-scenario framework. We continue to focus on growth and the ability to generate sustainable capital return to our shareholders over the long term.

With that, we would like to turn the call over to the operator for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). And our first question coming from the line of Tracy Benguigui from Barclays.

Tracy Dolin-Benguigui - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

I realize that the first quarter typically has higher seasonality and mortality losses, but it feels like your underwriting margins were compressed more this quarter than we typically see in first quarter. Can you elaborate the causes, like was this the flu or something else? And under the LDTI world, were these for cohorts with NPR above 100%?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Tracy, it's Ed. So this is a seasonally high quarter for mortality. But I think it's important to understand that it was beyond that. And we had more claims than the direct claims that I've talked about $400 million to $500 million of quarters being more normal. It was above the top end of that number. Also, the reinsurance offset was lower than what we have been seeing.

So I would say from both a claims standpoint as well as a reinsurance standpoint, it was worse than a typical quarter. But again, the seasonality is a contributing factor. So when we talked about run rate, the reason we suggested you only need to adjust for the alts performance was because we had some other favorability on expenses and on taxes a little bit that offset what we consider to be adverse underwriting relative to a normal average quarter.

Tracy Dolin-Benguigui - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

Okay. And just to understand earnings emergence under LDTI, were these for cohorts or the net premium ratio was above 100%?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Yes, I would say there really isn't much of an impact here when we're talking about LDTI or pre LDTI. So I don't think that's a factor here.

Tracy Dolin-Benguigui - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

Okay. Have you done a commercial real estate stress test? And if you did, if you could share your general findings, like did you stress valuations on your CMLs? And did that result in any meaningful changes in RBC?

John Lloyd Rosenthal - *Brighthouse Financial, Inc. - Executive VP & CIO*

Tracy, it's John. We do run a variety of both top-down and bottom-up stress scenarios on our CML portfolio and the impacts on the portfolio are manageable. As you know, we've already seen valuation decreases for office, in particular, and it's not unreasonable to expect them to continue to decline over the near term. However, we're starting from a position of strength, which you can see, a diversified, high-quality portfolio, including relatively low LTVs.

And the low LTVs give us significant cushion to protect against further declines in property values, even reasonably severe declines. So again, we feel pretty good about being able to weather any stress. And I believe we provide enough information on our CML Holdings, including LTV and coverage distributions to allow you to reach the same conclusion.

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

So -- and I would just add to that, Tracy, that you've heard me say repeatedly that we manage the company under a multiyear, multi-scenario framework. And the bad scenario for us has been the triple threat of a bear equity market, very low interest rates and a credit cycle. And if you look at where we are today, we are in a substantially better position from a rate standpoint because of all the protection we put on in 2022 when rates were up.

And when you look at the derisking efforts that we've had as well as the overall investment strategy, that John is talking to, those 2 things combined, I think, put us in a very good position when we think about this multiyear, multi-scenario framework.

Operator

And our next question coming from the line of John Barnidge with Piper Sandler.

John Bakewell Barnidge - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Curious, did surrender activity change at all as the quarter progressed? And what's your outlook for that going forward? Because I know it was quite elevated in the quarter.

David Alan Rosenbaum

John, this is David. So maybe just a couple of overall comments to start and then I'll talk about the pace. So as you know, we previously disclosed that outflows have historically been in the $1 billion per month range. But as you know, this number will be impacted by things like the normal timing of business coming out of surrender charge period.

We do have lapse assumptions for our products associated with interest rates. And our actual lapses have been very close to those expectations under that dynamic formula.

So when we think about this year, and given the blocks that are coming out of surrender coupled with where we are with higher sustained rates, we currently expect that outflows this year will be slightly higher than what we've seen historically, which is all consistent with our pricing assumptions.

So when you think about the pace that we saw throughout the quarter, really when we look back to the end of last year, at the very end, we saw outflows tick up a little bit, which is consistent with what I just mentioned, plus R&Ds, which happened at the end of the year. We saw that outflow -- those higher outflows continue into the first quarter with a modest increase later in the quarter, which was associated with blocks coming out of surrender and then in April, that outflow came back a little bit.

John Bakewell Barnidge - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

And then just a quick question on CRE. I didn't see it in the presentation. Can you talk about maybe occupancy levels in the office portfolio?

John Lloyd Rosenthal - *Brighthouse Financial, Inc. - Executive VP & CIO*

John, it's John. They're 86%.

Operator

And our next question coming from the line of Alex Scott with Goldman Sachs.

Alexander Scott - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

First one I have for you is just if you could provide any update on the multiyear, multi-scenario framework that you mentioned? It's been a while since we've gotten a look at what some of those projections look like. Any update on when that may become available? And if there's any way for you to opine on how the base case has evolved, particularly given the mean reversion point adjustment?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Alex, it's Ed. So I won't be able to give you any preview of how those numbers might look when we come out with distributable earnings. I did say, I think on the last call, and I would just reiterate it here that with the adoption of LDTI and with the efforts we have underway to make sure we're leveraging our actuarial transformation that we completed last year, the platform there for our projections that we were talking about midyear for distributable earnings this year versus in prior years, we had done it in March. So I would just say again that we're still targeting midyear and really not getting any more specific than that.

Alexander Scott - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Got it. Understood. And then the second question I have is just on the statutory net income loss. I was hoping you could help us bridge sort of the gap between that and normalize statutory earnings and what some of that movement was. And then separately, I'd also just be interested like how does that impact the unassigned surplus of BLIC? And I ask because I think that, that can be gating item for ordinary dividend capacity as we look into 2024. So I was just interested if that is an issue at all.

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Sure. So first of all, on the unassigned funds. If you look at our dividend capacity for this year for BLIC, it's $527 million, and that's down from about $1.5 billion previously. And the reason for that is that in the prior year, the gating factor was prior year statutory operating gain and the most recent, it's unassigned funds. I think the key point here, though, is that we've talked about a $300 million expectation of dividends for this year.

So we obviously have a lot of capacity to be able to deliver on the cash flows that we're talking about. I guess on the net loss to norm stat discussion, we do disclose that, obviously, in the supplement that you can see the walk. And one of the big things that we've talked about is how we manage the VA risk. So we're looking at gains and hedges that are both realized and unrealized.

And so what you're just seeing come through the statutory line will be the realized gains and losses as well as the CTE70 reserve movements, which, again, are different than the target that we're talking about when we're looking at CTE98 and RBC.

Operator

(Operator Instructions). And our next question coming from the line of Erik Bass with Autonomous Research.

Erik James Bass - *Bernstein Autonomous LLP*

First, I was hoping you could quantify the NAIC interest change -- interest rate change benefit on stat earnings in RBC this quarter?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Erik, it's Ed. So we said we had norm stat earnings of approximately $200 million. That was all due to VA, and it was really driven by the MRP change. We've said in the past, I think we've said at one point, $200 to $250 million. I think maybe another point we said $250 million to $300 million, I would say it's in the middle of those. It was around $250 million.

Erik James Bass - *Bernstein Autonomous LLP*

Got it. And then can you talk about policyholder behavior experience when Shield policies mature? And how much of those contracts are rolling into a new Shield policy versus lapsing or being exchanged for an annuity -- a new annuity contract with another carrier?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Yes. Sure, Erik. So we have a high shock lapse assumption for Shield when you get out of the guarantee period. And as David alluded to in his prior -- in the response to the prior question, that is a dynamic assumption. And so when we look at that shock lapse in the current rate environment, it is about as close to what you could be on an assumption. So that's why we're saying it's very much in line with what we would expect. And we don't assume a high percentage rolling into new Shield contract.

Erik James Bass - *Bernstein Autonomous LLP*

Got it. I guess, do you have any sense of how much that is or how much of your new sales are coming from kind of, I guess, churn? Maybe it isn't the right word, but essentially exchanges into new business?

David Alan Rosenbaum

Yes. Erik, this is David. I don't have a number, but I would say that just kind of qualitatively, we do retain some of the business, whether that's from renewals or internal exchanges. So we do, do that. But as Ed mentioned, we do have a lapse assumption -- a shock lapse assumption built into our pricing. And the experience has been tracking right in line with that assumption.

Operator

And our next question coming from the line of Ryan Krueger with KBW.

Ryan Joel Krueger - *Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research*

Could you talk about -- or can you quantify new business strain in the current quarter?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Sure. So when we're looking at the RBC ratio, we've talked in the past about a normal capital usage to fund growth of about 5 RBC points a quarter. So what -- the dynamic's a little bit different this year because of the substantial amount of fixed annuity sales that we had last year. And I think, Ryan, as you know, there is a calendar year capital charge for business risk that rolls off at the beginning of every year.

That is not a material consideration when you think about the Shield product, it is when you think about fixed annuities. And so because of the fact that, that capital charge rolls off at the beginning of every year, you are seeing in this first quarter, capital related to growth actually being a contributor to the RBC ratio.

So I would say, as you look forward, everything else being equal, assuming we continue to grow, that you will see capital usage over the next few quarters, which will put some downward pressure on the RBC ratio.

Ryan Joel Krueger - *Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research*

Would you expect to be above that 5-point impact near term, just given -- I know fixed annuity sales came down some, but they're still a fair amount higher than they had been running previously.

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

I would. And I would just simply -- now, again, it's going to be dependent on sales mix, right? And so remember, fixed annuities last year were more than $3.5 billion. In the year prior to that, they were $100 million. So we have been opportunistic in that market, depending on the environment and the margin that we can get. So it certainly is going to be heavily dependent on business mix.

But I would just say that if you assume, it's a normal quarter is 5 points of usage. And I told you that the first quarter was actually a contributor, right? For it to average 5 points of usage over a full year, you're going to have to have something more than 5 points per quarter. Again, everything else being equal, sales mix, et cetera.

Operator

Thank you, ladies and gentlemen, I will now turn the call back over to Dana Amante for any closing remarks.

Dana Amante - *Brighthouse Financial, Inc. - Head of IR*

Thank you, Olivia, and thank you all for joining us today and for your interest in Brighthouse Financial. Have a great day.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.
